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No. 214

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In the Supreme Court of the United States

OCTOBER TERM, 1962

JOSEPH L. O'HERN CO., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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OPINIONS BELOW

The opinion of the tax court (R. 8a-17a)[1] is reported at 35 T.C. 750. The opinion of the court of appeals (Pet. 17-26) is reported at 301 F.2d 813.

JURISDICTION

The judgment of the court of appeals was entered on April 9, 1962. (Pet. 1.) The petition for a writ of certiorari was filed on June 29, 1962. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

[1] Record references are to the appendix to the taxpayer's brief filed in the court of appeals.

QUESTION PRESENTED

An agent for the taxpayer entered into an agreement with the owner of certain stock, upon which a dividend had already been declared, to purchase the stock at a fixed price, conditioned upon the happening of an event in the future. The agreement also provided that any dividends paid or payable on the stock after the date of the agreement should be the property of the purchaser and should be paid over at the time of the payment of the purchase price. The event upon which the contract was conditioned did not take place until several weeks after the record date of the dividend in question, and shortly thereafter the stock was delivered to the taxpayers' agent who paid the seller the contract price less the amount of the intervening dividend. Thereupon the agent delivered to the taxpayer the stock and a check in the amount of the dividend and received from the taxpayer the contract price for the stock without any deduction on account of the dividend.

The question presented is whether, in this situation, the taxpayer received a dividend upon which it is entitled to a dividend-received deduction within the meaning of Section 243 (a) of the Internal Revenue Code of 1954.

STATUTE INVOLVED

Internal Revenue Code of 1954:

SEC. 243. DIVIDENDS RECEIVED BY CORPORATIONS.

(a) *General Rule.*—In the case of a corporation, there shall be allowed as a deduction an amount equal to 85 percent of the amount received as

dividends (other than dividends described in paragraph (1) of section 244, relating to dividends on the preferred stock of a public utility) from a domestic corporation which is subject to taxation under this chapter.

* * * * *

(26 U.S.C. 243(a).)

SEC. 316. DIVIDEND DEFINED.

(a) *General Rule.*—For purposes of this subtitle, the term "dividend" means any distribution of property made by a corporation to its shareholders—

(1) out of its earnings and profits accumulated after February 28, 1913 * * *.

* * * * *

(26 U.S.C. 316(a).)

STATEMENT

The facts as found by the tax court (R. 8a-13a) and accepted by the court of appeals (Pet. 18-23) may be summarized as follows:

The taxpayer is a corporation organized on December 22, 1954, under the laws of Pennsylvania. Its first income tax return was for the period December 22, 1954, to December 31, 1954. Thereafter, its returns were filed on a calendar-year cash basis. The taxpayer's return for the year 1955, the year involved here, was filed with the District Director of Internal Revenue at Philadelphia, Pennsylvania. (R. 8a-9a.) Accompanying

the filing of its first return was a letter to the Director which contained the following (R. 9a):

> This Corporation was organized under the laws of the State of Pennsylvania on December 22, 1954. From that date to December 31, 1954, there were no Assets or Liabilities acquired and there was no business transacted which would reflect Income or Expenses.

On December 7, 1954, American Locomotive Company wrote to Sutro Brothers & Company, stockbrokers, to confirm an understanding regarding the proposed purchase by Sutro from American of 53,000 shares of the outstanding common stock of General Steel Castings Corporation, a Delaware corporation, at a purchase price of $20 per share, or an aggregate purchase price of $1,060,000. (R. 9a.) The letter of December 7, 1954, stated that American hoped to obtain a so-called "no action" letter from the Securities and Exchange Commission the following week (R. 10a), but that if a "no action" letter was not received from the Securities and Exchange Commission on or before December 28, 1954, the agreement would become ineffective (R. 11a). The letter also provided (R. 11a) that:

> If the transaction is consumated as herein provided, all dividends paid or payable on the said stock after the date hereof shall be your property and shall be paid over at the time of payment of the purchase price, but without liability for interest thereon.

Previously, on October 29, 1954, General had declared a regular dividend of 30 cents per share and an extra dividend of 30 cents per share on its common stock. These dividends were declared to be payable and actually were paid on December 31, 1954, to stockholders of record on December 20, 1954. These dividends on the 53,000 shares in question, totaling $31,800, were paid to American, which was the stockholder of record on December 20, 1954. American reported the $31,800 as a dividend received on its income tax return for the year 1954. (R. 11a-12a.)

The Securities and Exchange Commission under date of January 11, 1955, issued a "no action" letter to American in regard to the proposed sale of 53,000 shares of General common stock. (R. 12a.) The sale of this stock was consummated on January 18, 1955, when certificates representing 53,000 shares of common stock of General were delivered by American to representatives of Sutro, and the latter handed American a certified check for $1,028,200, representing the purchase price of $1,060,000 less the $31,800 dividend which American had received on December 30, 1954. (R. 12a-13a.) Sutro purchased these shares as agent for the taxpayer. (R. 13a.)

The taxpayer paid for the 53,000 shares of General stock by checks delivered to Sutro on January 24, 1955, and January 25, 1955, for $1,060,000 plus the broker's commission. On January 26, 1955, Sutro delivered its check to the taxpayer for $31,800, representing the amount of the dividends paid by General to American on December 31, 1954. (R. 13a.)

American reported the sale of the 53,000 shares on

its income tax return for the year 1955. It reported that the sale took place on January 18, 1955, and that it received $1,028,200 as proceeds of the sale. (R. 13a.) It reported in its 1954 return that it had received a dividend in the amount of $31,800 on the stock. (R. 15a.)

At all pertinent times General was a domestic corporation, subject to taxation under Chapter 1 of the Internal Revenue Code of 1954. (R. 13a.)

On its income tax return for 1955 the taxpayer reported the sale of the 53,000 shares of General stock at a substantial profit and included the sum of $31,800 (representing the dividend) in the cost basis; it also included the $31,800 as a dividend received in 1955, and claimed a dividend-received deduction of 85% of the amount of the dividend. (See Ex. 2-B, attached to Stipulation of Facts.)[2] The Commissioner determined a deficiency for the year 1955 on the ground that short-term capital gains should be increased by $31,800 (the amount of the dividend) and the dividend income decreased in a corresponding amount, and that the dividend-received deduction should be reduced in the amount of 85% of $31,800. (See deficiency notice, attached to petition filed by taxpayer in the tax court).[3]

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[2] This exhibit, which is a copy of the taxpayer's 1955 return, does not appear in the appendix to the taxpayer's brief filed in the court of appeals but does appear in the original record transmitted by the Clerk of the Third Circuit to the Clerk of this Court.

[3] The deficiency notice does not appear in the appendix to the taxpayer's brief filed in the court of appeals but does appear in the original record transmitted by the Clerk of the Third Circuit to the Clerk of this Court.

The tax court decided that the payment of $31,800 to the taxpayer by Sutro was not a dividend under Section 243(a) of the Internal Revenue Code of 1954, as defined by Section 316(a) (R. 14a-15a); and that the payment was an adjustment of the purchase price (R. 16a).

The court of appeals affirmed, holding that it was only on January 11, 1955, that the taxpayer acquired a beneficial interest in the General stock, and that, accordingly, the taxpayer was not entitled to payment of the dividends accruable to stockholders of record or beneficial owners on December 20, 1954, and not entitled to the dividend-received deduction. (Pet. 25.)

ARGUMENT

1. The decision of the court below is correct. In order for the taxpayer corporation to be entitled to a dividend-received deduction under Section 243 (a) of the Internal Revenue Code of 1954, *supra*, p. 2, it is necessary for it to show that the distribution of $31,800 on January 26, 1955 (R. 13a), was made to it as a shareholder of General within the meaning of Section 316(a), *supra*, p. 3. Since American was the stockholder of record on December 20, 1954 (R. 12a), and actually received the dividend, American was entitled to the dividend-received deduction under the statute, unless the taxpayer could show that it was the beneficial owner of the General stock on the dividend record date. See *Rupe Investment Corp.* v. *Commissioner*, 266 F.2d 624, 629-630 (C.A. 5th); *Northern Trust Co. of Chicago* v. *United States*, 193 F.2d 127, 131 (C.A. 7th), certiorari denied, 343 U.S. 956. As both the

tax court and the court below decided (R. 15a; Pet. 25), the agreement by American to sell the General stock was conditioned upon the prior receipt of a "no action" letter from the Securities and Exchange Commission (R. 10a); since this letter was not issued until January 11, 1955 (R. 12a), the taxpayer was not the beneficial owner of the General stock on the record date of December 20, 1954. Therefore, when Sutro paid the taxpayer $31,800 on January 26, 1955, an amount equivalent to the dividend paid by General on December 31, 1954 (R. 13a), it did not pay a dividend within the meaning of Section 243(a) of the 1954 Code. As stated by both courts below, the payment was simply an adjustment of the sales price. (R. 16a; Pet. 26.)

2. The taxpayer alleges (Pet. 12-13) that the decision of the court below is in conflict with *DeGuire* v. *Higgins*, 159 F.2d 921 (C.A. 2d), certiorari denied, 331 U.S. 858; *Northern Trust Co. of Chicago* v. *United States*, *supra*; and *Miller* v. *Commissioner*, 247 F.2d 206 (C.A. 7th), certiorari denied, 355 U. S. 939. None of those cases involved the application of Section 243(a) of the 1954 Code. In each, however, the court was called upon to determine whether the buyer or the seller of certain stock should have included the particular dividends in gross income—a question which depended upon whether the buyer or the seller was the beneficial owner of the stock on the dividend record date. Construing the contract of purchase in the instant case, which differs materially from the agreements in the above-cited cases, the courts below properly concluded that the facts showed that taxpayer was not the beneficial owner of the General stock on the dividend record date,

and that the payment to the taxpayer of $31,800 by its agent in January, 1955, was actually an allowance in reduction of the cost of the stock. (R. 16a; Pet. 25.)

The taxpayer apparently believes (Pet. 3, 15) that the provision in the letter of December 7, 1954, stating that (R. 11a) "all dividends paid or payable on the said stock after the date hereof shall be your property and shall be paid over at the time of payment of the purchase price", should determine whether or not the payment of $31,800 was a dividend within the meaning of Section 243(a). But the labels employed by the parties obviously are not controlling. The legal conclusion to be drawn from a contract is for the courts. See *Bakers' Mutual Coop. Ass'n* v. *Commissioner*, 117 F.2d 27, 28 (C.A. 3d). In *Talbot Mills* v. *Commissioner*, 326 U.S. 521 (decided with *John Kelley Co.* v. *Commissioner*), where the legal document was described by the parties as a note and the payments as interest, this Court nevertheless held that the payments were dividends for income tax purposes.

CONCLUSION

The decision below is correct, and the case, which turns upon its own facts, is of no general importance. The petition for a writ of certiorari should be denied.

Respectfully submitted.

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